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May 7, 2003

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, D.C. 20554

Re: Written *Ex Parte*
MB Docket No. 02-277 and MM Docket Nos. 01-235, 01-317 and 00-244
2002 Biennial Regulatory Review of the Commission's Broadcast Ownership Rules and Other Rules

Dear Ms. Dortch:

Please find attached the written *ex parte* submission of Cox Enterprises, Inc., responding to the April 21, 2003 filing of Fox Entertainment Group, Inc. and Fox Televisions, Inc., National Broadcasting Company, Inc. and Telemundo Communications Group, Inc. and Viacom in the above-captioned proceeding. Should there be any questions regarding this filing or its subject matter, please contact Mr. Alexander Netchvolodoff, Senior Vice President of Public Policy, Cox Enterprises, Inc., at (202) 296-4933.

Pursuant to Section 1.1206(b) of the Commission's rules and the Commission's *Notice of Proposed Rulemaking* in this proceeding, an original and one copy of this letter and enclosure are being submitted to the Secretary's office for the above-captioned docket, and copies also are being provided to Ms. Mania Baghdadi, Ms. Linda Senecal, and Qualex International.

Respectfully submitted,

To-Quyen Truong

TTT/
cc: Mania Baghdadi
Linda Senecal
Qualex International (2 copies)

Alexander Netchvolodoff
Alexandra Wilson
Cox Enterprises, Inc.

No. of Copies rec'd 0+1

COX ENTERPRISES, INC.
Written *Ex Parte* in MM Docket Nos. 02-277, 01-235, 01-317 and 00-244

<u>THE MAJOR BROADCAST NETWORKS & RETRANSMISSION CONSENT</u>

On January 2, 2003, Cox Enterprises, Inc. ("Cox") submitted to the Commission detailed information and analysis regarding the major broadcast networks' ("Networks") extensive web of ownership interests and how the vast scale and scope of those interests have enabled the Networks to engage in a variety of practices that promote their national programming agenda to the detriment of consumers and the public policy principles embodied in the Communications Act, especially localism. Among other things, Cox described the Networks' behavior and demands in several recent negotiations involving the efforts of Cox Communications, Inc. to secure retransmission consent for local television stations owned and operated by the Networks ("Network O&Os").[1] In order to obtain that retransmission consent, Cox Communications began carrying, at inflated rates, a number of Network-owned cable channels on all of its cable systems, even those that do not carry a Network O&O.

On April 21, 2003, nearly four months after Cox' original filing and three months after reply comments were due in this proceeding, the Networks submitted a cursory economic analysis prepared by Economists, Inc. ("EI") that purports to explain why the Commission should not be concerned in this proceeding about the retransmission consent behavior described in Cox's comments. The Networks' retransmission consent strategies, of course, are only one troubling aspect of a much broader pattern of harmful behavior in which the Networks have been able to engage as a result of their substantial vertical and horizontal concentration. The Networks are unwilling, or unable, to address the fundamental point established by Cox in its filings – that even a seemingly incremental increase in the cap would cause exponential harm to the public, precisely because Network consolidation harms multiple aspects of media development, production and distribution, of which retransmission consent is only one.

Even on the issue of retransmission consent, however, the Networks have not refuted Cox's evidence regarding their tying arrangements.[2] Rather than providing a fulsome analysis, the Networks' brief filing attempts to belittle Cox's evidence and analysis as nothing more than the "Red Herring" arguments of a "Deregulation Foe." But the Commission has a serious responsibility to review its rules under Section 202 and respond to court remands. In conducting its review and defending its decision in court, the Commission must rely on substantive, fact-based comments consistent with prevailing law, not on sarcastic quips or unsubstantiated

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[1] Cox Comments at 41-47.

[2] Cox's February 13, 2003, *ex parte* filing reiterated that none of the Networks – including ABC – offered Cox Communications a cash alternative during the retransmission consent negotiations detailed in Cox's January 2 Comments. Cox noted that Disney/ABC should clarify the submitted affidavit of Mr. Benjamin Pyne of ABC Cable Networks Group, attached as Exhibit A to Disney/ABC's Reply Comments, so that the obviously intended inferences to the contrary are neither disingenuous nor misleading. The Networks, including Disney/ABC, have failed to respond.

"economic" musings. Strikingly absent from EI's submission is any citation to any supporting authority, study or other evidence regarding the actual market conditions which the study purports to discuss. As described in detail below, the theoretical market about which the study opines does not begin to reflect the complexities of the broadcast environment and its importance to local communities, as established by the Communications Act. Moreover, the EI report fails to account for the calculated and anticompetitive behavior of the Networks described in the Cox Comments. We expose below the fallacies of the assumptions underlying the EI study and show that the study itself reveals that the Networks do in fact exercise market power in retransmission consent negotiations through practices that directly harm the public interest.

I. The Broadcast Regulatory Environment, Including the Retransmission Consent Process, Is Designed to Protect the Public Interest.

EI's first mistake is to overlook completely the numerous ways in which the government has taken regulatory action to ensure that broadcasters and cable operators do not operate in a perfectly "free" competitive market. Far from letting market forces alone determine whether broadcast television signals are received by the American public, Congress has established a comprehensive regulatory framework that actively promotes the universal availability of over-the-air television stations. Rather than being indifferent to the outcome of retransmission consent negotiations, Congress and the Commission have a strong policy preference for and have designed the retransmission consent process to preserve local broadcast service to local communities – specifically, to enable the local broadcast station to bargain for compensation to reflect its value to a local cable system and its local community.

EI characterizes the relationship between the Networks and cable operators (as well as the Networks and their broadcast affiliates) as typical "producer/distributor" arrangements. It then proclaims that "[d]isputes between producers and distributors are not normally appropriate for antitrust resolution because typically they do not involve the exercise of market power." (EI filing, at 6.) It goes on to distinguish between market power and bargaining power and discusses why the former but not the latter is subject to antitrust law. It further claims that issues of bargaining power are not "a matter of legitimate public policy concern." (EI filing, at 14.)

This discussion of antitrust law may be of special interest to the Department of Justice and the Federal Trade Commission, which are charged with enforcing the antitrust laws. But the FCC operates under the Communications Act and its public interest mandate. As the D.C. Circuit Court emphasized in *Fox*, the FCC must design its media ownership rules to protect not only competition (a principle not solely limited to antitrust law), but also diversity and localism. (*Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1042 (D.C. Cir. 2002).) With respect to the goal of preserving competition, the Networks' behavior in the retransmission consent negotiations described by Cox does in fact raise concerns about the harmful exercise of market power, as discussed below. But even if EI were correct that "only" bargaining power is implicated in those negotiations, the clear public interest harms flowing from the Networks' practices would have no antitrust remedy. Thus, the EI analysis simply proves the point that the FCC, and not the antitrust agencies, is the appropriate legal forum to address the Networks' market behavior, whether it is Network "market power" or "bargaining power" or simply "power" that is being exercised to the detriment of the public interest.

II. Cable Operators Are Not Free to Negotiate Over Retransmission Consent Under Efficient Market Conditions.

As noted above, the EI analysis rests on the assumption that the parties to retransmission consent agreements act freely on the level playing field of a market that is perfectly competitive. That assumption is false. Retransmission consent negotiations are not based on the competitive market paradigm of parties with equal legal rights negotiating to reach a mutually beneficial agreement.

First, retransmission consent negotiations are governed not by the market but by Commission rules, covering everything from the requirement that must carry/retransmission consent elections be made every three years, to the prohibition against cable operators dropping a broadcast station during sweeps. The government compels cable retransmission of broadcast station signals through numerous means, ranging from formal must-carry and retransmission consent rules to local political pressure for a cable operator to make the concessions necessary to continue retransmission when heated negotiations lead to Network threats to disrupt carriage. Conversely, a broadcast station opting initially for retransmission consent has a government-established alternative that it can select at the next election in case retransmission consent doesn't work to its satisfaction, *i.e.*, must-carry rights.

Second, Congress' policy and the Commission's mandate to ensure reasonable basic cable rates preclude a cable operator from increasing subscribers' basic rates significantly, or forcing only those subscribers in systems with Network O&Os to bear the full brunt of an expensive retransmission consent agreement. Accordingly, that theoretical alternative, posited by EI for a cable operator faced with a Network demanding nationwide carriage of its affiliated cable channels in exchange for retransmission consent, is no alternative to cable operators subject to such a variety of regulations.[3]

Third, none can deny the reality that cable operators cannot forego carriage of Network stations. Each of the top four broadcast networks still has substantially greater audience appeal than any individual cable network. The Networks, on behalf of their O&O stations, use retransmission consent negotiations as opportunities to broadly expand the distribution of their vast web of programming interests. When heated negotiations threaten retransmission of Network stations, it is the cable operator that holds the losing cards, a lesson Time Warner learned only too well in its confrontation with Disney/ABC, as did Cox in its 1999-2000 negotiation for retransmission of WTTG in Washington, D.C. and other Fox O&Os, as discussed in Cox's Comments. As proof of Network market power, no cable operator has ever endured a

[3] It is important to note that cable's DBS competitors are not subject to the same regulatory constraints. By law, cable must offer broadcast Network signals on the basic tier of service, which must be purchased in order to receive other programming services. By contrast, DBS can and does offer broadcast station signals in a separate, non-mandatory service tier that it prices free from the threat of rate regulation. Thus, it is easier for a DBS provider to credibly say "no" in negotiations with a broadcaster over inclusion in an optional service tier than it is for a cable operator for whom the Network station is part of the mandatory basic tier.

Network's withholding of its O&O signals for an appreciable period without eventually capitulating to economic demands that far exceed current rates of inflation.

NewsCorp.'s bid to acquire control of DirecTV only adds another layer of retransmission consent complication for cable operators, and another threat to consumer interests. A Fox/DirecTV merger would create every incentive for Fox to make increasingly extreme demands on cable operators during retransmission negotiations and exponentially reduce cable operators' ability to resist those demands. If cable operators refused to meet those demands and Fox withheld its O&O station signals, then the operators would surrender to Fox/DirecTV a decisive competitive lever that undoubtedly would draw viewers away from cable and towards DirecTV. And if cable operators capitulated to a merged Fox/DirecTV's unreasonable carriage demands, then cable rates would inevitably rise, yet again leading viewers to DirecTV. Operators' ability to limit cable rates and to tailor the cable line-up to their customers' taste would surely be curtailed with a merged Fox/DirecTV competitor, all to the detriment of consumers.

III. The Networks' Retransmission Consent Tactics Are Exercises of "Market Power" and Directly Harm Consumers.

The Networks' use of the retransmission consent process as a vehicle for demanding nationwide carriage of their affiliated cable channels at inflated rates distorts local markets and limits local communities' programming choices. EI theorizes that the parties to these negotiations still engage in a local market-by-market evaluation, and posits that increased Network ownership of stations nationwide thus has no adverse impact on the retransmission consent process. And even if this were not true, EI asserts, any shift in the dynamics of retransmission consent negotiations would be an exercise of Network "bargaining power" and not "market power," and hence should be of no concern to the Commission.

As discussed below, however, closer analysis reveals these claims to be false. The Networks' retransmission consent tactics are exercises of market power that have warped the retransmission consent process and caused direct harm to consumers' interests – the central concern of the FCC's mission, and one entirely lost in EI's discussion of Network and operator profitability.

A. The Networks' Retransmission Consent Tactics Result in a Form of Forced Subsidy by Some Consumers, Particularly Those in Small, Rural Markets.

As the EI study expressly recognizes, the Networks' demands for carriage of their non-broadcast cable channels, as part of the quid pro quo for retransmission consent, can result in the cable operator carrying and paying for these cable channels on terms it would not accept otherwise. (EI filing, at 14-15.) In exchange for retransmission consent, the cable operator agrees to carry and pay inflated rates for Network-affiliated cable channels, not only in O&O markets, but also in non-O&O markets nationwide. In all cable markets, the costs of the Networks' cable programming are borne by the customers receiving that programming. Thus, cable customers in non-O&O markets are forced to subsidize cable customers in O&O markets, because they must bear part of the retransmission costs without obtaining the corresponding benefit of being able to watch the Network O&Os. In addition to out-of-pocket payment of inflated cable rates, these customers also suffer the lost opportunity of receiving programming that might be more desirable in their local communities than the Network-affiliated cable channels that the cable operator, unconstrained by retransmission consent negotiations in a distant market, would not select.

Because most Network O&Os are in the top 30 markets, the harms from these one-sided negotiations fall disproportionately on consumers in the other medium and small-sized markets. As EI emphasizes, moreover, the Networks must maximize the number of eyeballs viewing their programming nationwide in order to maximize the advertising revenue that is their main source of profits. (EI filing, at 11.) That goal is achieved by gearing their broadcast and cable programming to the tastes of audiences in the large, urban markets. Accordingly, at the same time that cable consumers in medium and small, rural markets are forced to subsidize their counterparts in large, urban markets, their local values and interests are discounted or ignored altogether in Network programming decisions.

The harm to the public that would be caused by relaxing or eliminating the 35-percent national television ownership cap is easily explained in the context of retransmission consent. As the percentage of the national audience covered by a Network's O&Os increases, so does its leverage to coerce cable operators into carrying its cable programming or face the loss of carriage of the valuable O&O signals. If a Network owned only one station, its ability to insist on carriage of its cable programming in all markets would be significantly limited; a cable operator could simply face non-carriage of the Network signal in the one market. At the other extreme, if a Network owned all of the broadcast stations carrying its signal, that Network would have substantial leverage to insist on carriage of its affiliated cable programming on all cable systems, to the detriment of the viewing public. If the national cap were lifted above 35 percent, the Networks' ability to insist that American cable consumers be limited to choices of less valuable programming at inflated prices would substantially increase, not decrease. And consumers in medium and small-sized markets would be twice harmed: first, by paying for retransmission of Network O&O signals that they are unable to watch; and second, by having fewer choices of cable programming unrelated to the Networks.

The ability to spread the costs of retransmission consent to consumers who derive no benefits from it also removes a constraint that an efficient market otherwise would place on escalations in the price of retransmission rights. The proliferation of Network-affiliated channels on the most desirable cable tiers and the skyrocketing rates paid by cable operators – but ultimately borne by consumers – attest to this economic reality.

B. The Networks' Use of Their Nationwide O&O Footprint to Demand Nationwide Carriage of Their Cable Channels Prevents the Efficient Operation of Local Market Forces.

Congress established the broadcast and retransmission consent statutory framework to ensure that programming decisions are based on the demands of local communities.[4] Yet the

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[4] *See Implementation of the Cable Television Consumer Protection and Competition Act of 1992, Broadcast Signal Carriage Issues*, Memorandum Opinion and Order, 9 FCC Rcd 6723, 6745 (1994).

Networks' use of their nationwide footprint of top-market stations to demand nationwide carriage of their affiliated cable channels eliminates any potential that retransmission consent and related cable carriage decisions would be based on local consumer demand, without regard to their impact on other markets nationwide. For example, as the discussion in Section III.A. above illustrates, a cable operator negotiating for rights to the full slate of a Network's O&O signals must consider how denial of the Network's cable channel carriage demands in non-O&O markets would result either in the loss of retransmission of Network stations or a major increase in basic cable rates in O&O markets. As a result, programming decisions become more and more divorced from the demands and tastes of local communities, in direct contravention of congressional intent and the statutory framework.

A prime example of this phenomenon is the Cox - Disney/ABC retransmission consent experience described in Cox's Comments. (Cox Comments at 43-44.) Even though Disney/ABC owns only a fraction of the stations in Cox's cable service areas, their O&Os are in key markets and they also own some of the most valuable cable channels. Disney/ABC's tying of these key O&Os and cable properties with its SoapNet channel allowed it to force Cox's launch and carriage of the latter in both O&O and non-O&O markets nationwide on terms otherwise unacceptable to Cox.

If allowed to acquire more stations, the Networks would own even more O&Os in key markets and thereby increase their ability to demand cable channel carriage and compensation at even higher rates. Potential damage to a cable operator's "goodwill" increases dramatically the more stations that are involved in a single negotiation, and the political fall-out from not reaching a carriage agreement increases exponentially the more stations that are involved at the same time.

C. The Networks' Retransmission Tactics Are Exercises of "Market Power."

The Networks' retransmission consent tactics prevent cable operators from selecting programming based principally on their local customers' demands, and prevent unaffiliated cable channels from competing on an equal basis in the cable programming market. As explained by EI's own analysis, these Networks practices are in fact exercises of two forms of "market power" which lead directly to restricted output and reduced competition in the video programming marketplace.

1. Restricted Output

As EI explains, "[t]he exercise of market power reduces overall benefits to society because it restricts output." (EI filing, at 14.) That is precisely the outcome of some retransmission consent negotiations between the Networks and cable operators. The cable operator has a fixed bandwidth capacity that it can use to provide programming to consumers. It must configure that capacity in various ways to serve different types of consumers – some who prefer just a basic cable service; others who prefer a far greater variety of programming. To attract customers, the cable operator has every incentive to offer attractive packages that offer a wide range of programming valued by consumers. When a Network uses retransmission consent for its slate of top-market stations to insist on carriage of other less valuable cable channels that the cable operator would not carry otherwise, the package of offerings available to consumers is less attractive and of lower quality, conditions that are encompassed in the term "restricted output." The Networks' practice of using the same "repurposed" programming for their broadcast and cable channels only exacerbates this problem of reduced quality and variety in the programming that a cable operator could offer.

The response may well be that the cable operator could allow the Networks to withhold their O&O signals altogether, but this is simply a restatement that programming output would be reduced. When the Networks refuse to bargain in good faith on a market-by-market basis, the net result is a reduction in the quality of the programming line-up available to cable consumers, a simple form of EI's "market power."

2. Reduced Competition

The Networks' practices not only reduce output, but also reduce the competing sources of programming that the cable operator can carry. As EI observes, "[i]n general, so long as competition is preserved at the producer level, so-called vertical 'restraints' ... are far more likely to benefit consumers than to harm them." (EI filing, at 6.) But competition in the production of video programming is not preserved when the Networks require carriage of their cable channels in exchange for retransmission of O&Os. The Networks' tilting of the playing field reduces the opportunities for other cable programming producers to compete for cable carriage, and as EI correctly observes, consumers are likely to be harmed.

Programming space on the cable system may be likened to the shelf space in a supermarket, available to a range of vendors. To attract customers, the supermarket owner has every incentive to fill his shelf space with a wide range of the products that are most desired by customers in his local shopping area. The variety, quality and pricing of the products occupying that shelf space suffer when a vendor who occupies a significant part of the space threatens to withdraw unless he gets more shelf space (and better placement and higher prices) for more of his products. The vendor's ability to extract these terms from the supermarket owner demonstrates his market power. It also increases the vendor's market power even further by reducing the shelf space available to competing vendors and hence the sources of competing products available to consumers. The same is true of the Networks' demands for carriage on local cable systems and the resulting "crowding out" of competing programming providers from the system.

These exercises of the Networks' market power, and the consequent harm to consumers, occur even in the case of single-system cable operators. Thus, contrary to EI's assertions regarding the absence of any impact on small cable operators, increasing the number of stations the Networks can own also increase the number of markets where single-system cable operators face highly vertically integrated Networks, resulting in further distortion of local markets and loss of consumer welfare.

IV. In the Absence of Commission Adoption and Enforcement of Effective Behavioral Rules, Retention of the 35% Cap Is Necessary to Keep Network Abuses in Check.

The record in this proceeding shows that market changes in the last seven years, since Congress reluctantly increased the national TV ownership cap to 35-percent, demonstrate that, if anything, the cap should be adjusted downward, not upward. Nothing in the record suggests that further relaxing the cap would serve the public interest.

The Networks and EI state that a behavioral rule – specifically, the statutory "good faith" negotiation requirement – is a more appropriate instrument than an ownership rule to remedy the retransmission consent harms identified in this proceeding. But the Networks have not met and cannot meet their burden of proving that the "good faith" negotiation requirement makes the 35-percent cap unnecessary to prevent Network retransmission consent abuses. As reflected in the record evidence, the broad "good faith" negotiation requirement has not prevented the Networks from engaging in anticompetitive behavior that harms local consumer interests. Although it may well be that specific, well-crafted behavioral rules and accompanying procedures for prompt enforcement could help ameliorate some of these harms, the simple fact remains that such rules and procedures do not now exist. In the continued absence of behavioral rules and consistent enforcement of such rules to address the harms flowing from Network consolidation, relaxing or eliminating the 35-percent national TV ownership cap would only exacerbate these problems, further damage the interests of American consumers, and undermine the public interest principles of the Communications Act.